

Revenue Generating Activities of Nonprofit Organizations

- Jennifer Kassan, Managing Director
 - Katovich Law Group
 - (510) 834-4530
 - jenny@katovichlaw.com

“Charities should not have to divert scarce resources away from accomplishing their charitable purposes and toward lawyers fees every time they engage in a commercial enterprise.”

A Call for Reform of the Operational Test For Unrelated Commercial Activity In Charities
Jessica Peña & Alexander L.T. Reid
New York University Law Review (Vol. 76:1855, December 2001)

Code of Federal Regulations 501(c)(3)-1(e)

Organizations carrying on trade or business—(1) In general.

An organization may meet the requirements of section 501(c)(3) although it operates a trade or business as a substantial part of its activities, if the operation of such trade or business is in furtherance of the organization's exempt purpose or purposes and if the organization is not organized or operated for the primary purpose of carrying on an unrelated trade or business

In determining the existence or nonexistence of such primary purpose, all the circumstances must be considered, including the size and extent of the trade or business and the size and extent of the activities which are in furtherance of one or more exempt purposes.

The Smell Test

- Does this smell like a commercial activity?
- Courts often look to ALL activities instead of just unrelated activities.

Factors in the Facts-and-Circumstances Test

- Profitability
- Competition with For-Profit Sector
- Fees Compared to Costs (c.f. competition factor)
- “Commercial Hue” (tautological)
- Who is receiving services
- Organization's funding sources
- Advertising
- Others

Commensurate-In-Scope Test

the amount of expenditures of an organization for charitable purposes must be taken into consideration in equating business activities with charitable activities

the primary purpose of an organization is charitable if the charitable activities are “commensurate in financial scope with its financial resources and its income from its business activities and other sources.”

Gen. Couns. Mem. 34,176 (July 30, 1969)

The Service's Treatment of Commercial Activity

“The Service’s unofficial position is to allow considerable amounts of commercial activity before questioning a charity’s qualification for exemption.” Peña & Reid

Example: In a 1994 Private Letter Ruling, the Service did not revoke the tax exemption of a charity that was engaged in the sale of herbs and that planned to enter into an agreement with a for-profit distributor. The organization’s purpose was to provide instruction and promote the practice of traditional medicinal systems.

The sale of herbs was initially expected to generate thirty percent of the revenues, but actually had generated eighty to eighty-one percent of the organization’s revenue. Even more surprising, because the sale of herbs was found to be a related activity, the charity was not required to pay UBIT.

Priv. Ltr. Rul. 94-36-002 (Jan. 26, 1994)

Examples

- Job Training for Disadvantaged Populations
- Publishing
- Consulting
- Sponsorship vs. Advertising
- Student Loans
- Charging fees for charitable activities
- Business Improvement Districts